

1 Craig C. Corbitt (83251)
2 Michael S. Christian (212716)
3 ZELLE HOFMANN VOELBEL & MASON LLP
4 44 Montgomery Street, Suite 3400
5 San Francisco, CA 94104
6 Telephone: (415) 693-0700
7 Facsimile: (415) 693-0770
8 ccorbitt@zelle.com
9 mchristian@zelle.com

E-filing

6 | Counsel for Plaintiff

7

**UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA**

SCOTT CALDWELL, on behalf of himself and
all others similarly situated,

~~Case No. 1~~

1928

CLASS ACTION COMPLAINT

12 Plaintiff,

JURY TRIAL DEMANDED

13 | vs.

NETFLIX, INC.; WAL-MART STC
and WAL-MART.COM USA LLC.

MEJ

16 Defendants.

18 NOW COMES Plaintiff Scott Caldwell for his Complaint brought under Sections 1 and 2
19 of the Sherman Antitrust Act, 15 U.S.C. §§ 1-2, and Sections 4 and 16 of the Clayton Antitrust
20 Act, 15 U.S.C. §§ 15 & 26, for treble damages and injunctive relief against Defendants Netflix,
21 Inc. (“Netflix”), Wal-Mart Stores, Inc. (“Wal-Mart Stores”), and Wal-Mart.com USA LLC
22 (“Walmart.com”).

23 Based upon personal knowledge, information, and belief, and the investigation of counsel,
24 Plaintiff alleges as follows:

NATURE OF THE ACTION

26 1. This suit is brought as a class action pursuant to Rule 23 of the Federal Rules of
27 Civil Procedure on behalf of a plaintiff Class, defined more fully below, consisting of all persons
28 and entities that paid a subscription fee to Defendant Netflix to rent DVDs between May 19, 2005

1

1 and the date of class certification (the "Class Period").

2 2. On or before May 19, 2005, Defendants completed and entered into an illegal
3 anticompetitive agreement (the "Market Allocation Agreement") to divide the markets for sales
4 and online rentals of DVDs in the United States, with the purpose and effect of monopolizing and
5 unreasonably restraining trade, in at least the market for online DVD rentals (the "Online DVD
6 Rental Market"). The mechanics of the Market Allocation Agreement, as set forth herein, allowed
7 Defendant Netflix to charge supracompetitive prices to Plaintiff and other Class members.

8 3. At the beginning of 2005, Defendants Netflix and Walmart.com were competing
9 directly in the Online DVD Rental Market. Walmart.com viewed its relatively new online rental
10 program, "Wal-Mart DVD Rentals," as a success, expressing considerable optimism about the
11 future growth of the service. In early January 2005, Walmart.com reduced the price of its most
12 popular online DVD rental program, reflecting its plans to expand in that market, which placed
13 further price pressure on Netflix. Facing growing competition from Walmart.com, in January
14 2005, Netflix CEO Reed Hastings invited Walmart.com CEO John Fleming to dinner for a
15 meeting to discuss their (then) competing businesses.

16 4. Fleming accepted the invitation; that meeting and other communications led to
17 Defendants entering the Market Allocation Agreement, pursuant to which Walmart.com agreed to
18 exit the Online DVD Rental Market and Netflix agreed not to enter the retail DVD market, but
19 instead to actively promote DVD sales by Wal-Mart Stores and Walmart.com.

20 5. Since entering into the Market Allocation Agreement, neither Wal-Mart Stores nor
21 Walmart.com has rented DVDs online and Netflix has not sold new DVDs. The Market
22 Allocation Agreement served to eliminate all competition (including price competition) between
23 Walmart.com and Netflix in the Online DVD Rental Market, entrench and enhance Defendants'
24 dominant market positions, and otherwise cause harm to competition, including enabling Netflix to
25 charge higher subscription prices for online DVD rentals than it would have had they not entered
26 into the Agreement. Plaintiff and all other similarly situated consumers did in fact pay and
27 continue to pay higher subscription prices to Netflix than they otherwise would have as a result of
28 Defendants' conduct.

PLAINTIFF

6. SCOTT CALDWELL is an adult individual who resides in San Francisco, California. During the Class Period, Mr. Caldwell directly subscribed to Netflix for his personal, non-commercial use and paid Netflix fees in connection therewith. The subscription fees Mr. Caldwell paid to Netflix were supracompetitive; they were greater than he would have paid, but for the antitrust violations alleged herein. Mr. Caldwell thereby suffered injury in his property, in the form of overcharges, injury which the antitrust laws are intended to prevent and remedy.

DEFENDANTS

NETFLIX

7. Defendant Netflix is a Delaware corporation headquartered at 100 Winchester Circle, Los Gatos, California, 95032. Netflix is publicly traded on the NASDAQ under the symbol NFLX. Its revenues earned from engaging in interstate commerce exceed \$2 billion annually. Through its website, www.netflix.com, Netflix rents DVDs directly to consumers nationwide by charging monthly subscription fees, which entitle customers to rent DVDs pursuant to various subscription plans. Netflix has possessed a market share of at least 75% of the Online DVD Rental Market in the United States, as defined herein, at all times during the Class Period.

WAL-MART

8. **Wal-Mart Stores.** Defendant Wal-Mart Stores is the largest retailer in the United States. Wal-Mart Stores is a Delaware corporation headquartered at 702 S.W. 8th Street, Bentonville, Arkansas, 72716. Wal-Mart Stores is publicly traded on the New York Stock Exchange under the symbol WMT. Its revenues earned from engaging in interstate and foreign commerce exceed \$400 billion annually. Through its retail stores and its website, www.walmart.com, Wal-Mart Stores sells new DVDs directly to consumers nationwide. Wal-Mart Stores sells far more DVDs than any other retailer in the United States, accounting for about 40% of all new DVDs sold to consumers domestically. During fiscal years 2005-2008 combined, it and Walmart.com had revenues in excess of \$25 billion from selling DVDs to consumers. Prior to the Market Allocation Agreement, Wal-Mart Stores' wholly-owned subsidiary Walmart.com

1 competed with Netflix in the Online DVD Rental Market through the “Wal-Mart DVD Rentals”
2 service, which was available on www.walmart.com.

3 9. **Walmart.com.** Defendant Walmart.com is a California Limited Liability Company
4 with offices at 7000 Marina Boulevard, Brisbane, California, 94005. Its corporate registration with
5 the California Secretary of State (as of April 8, 2011) lists its address as 702 S.W. 8th St.,
6 Bentonville, AR 72716—the same address as Wal-Mart Stores. It is the online component of Wal-
7 Mart Stores’ retail empire that is the leading seller of new DVDs in the United States.

8 10. Prior to the conspiracy alleged herein, Walmart.com was also a major competitor of
9 Netflix in the Online DVD Rental Market through the “Wal-Mart DVD Rentals” service, which
10 was available on www.walmart.com. While its financials are not publicly reported by Wal-Mart
11 Stores, Walmart.com is ranked as the 14th largest online retailer in the United States.
12 Walmart.com sells new DVDs directly to consumers nationwide. Consumers who purchase DVDs
13 via www.walmart.com may have them either mailed or otherwise delivered to them directly, or
14 may pick them up at a Wal-Mart Stores retail location via Walmart.com’s and Wal-Mart Stores’
15 “Site to Store” program.

16 11. **Wal-Mart Stores and Walmart.com.** Walmart.com and Wal-Mart Stores are, in
17 essence, operated as a single commercial enterprise and hold themselves out to the public as such,
18 by which Walmart.com is an internet sales channel for Wal-Mart Stores, rather than being an
19 independent business entity. Wal-Mart Stores is the registrant of the www.walmart.com domain
20 name that is used to sell products and services by Walmart.com. Likewise, Wal-Mart Stores is the
21 registrant of www.walmartdvdrentals.com. Wal-Mart Stores’ then-Chief Marketing Officer John
22 Fleming explained the relationship between Wal-Mart Stores and Walmart.com as follows:

23 Walmart.com was set up as a separate company, with outside investors and with
24 Wal-Mart owning a majority. The idea was that Walmart.com was going to tap into
25 customers Wal-Mart didn’t have and, in doing so, would defend our position as the
26 world’s largest retailer. We saw very quickly that this wasn’t how customers
 viewed the online channel. Within six months, Wal-Mart bought back the outside
 interest.

27 12. **Wal-Mart Stores’ Active Participation in the Conspiracy.** Wal-Mart Stores was
28 actively involved in the conspiracy alleged herein, as alleged more specifically below. For

1 purposes of these allegations, both Wal-Mart Stores and Walmart.com are active participants in the
2 conspiracy and each is liable for the unlawful conduct alleged herein, with each, among other
3 things, participating in, and benefiting from, the Market Allocation Agreement. Moreover, Wal-
4 Mart Stores directed, ratified, approved, supported, and otherwise aided and abetted
5 Walmart.com's violations of law.

6 13. Wal-Mart Stores had a strong motive to conspire with Netflix. In addition to its
7 interests as the 100% owner of Walmart.com, Wal-Mart Stores had further incentives to enter into
8 the Market Allocation Agreement, since it obtains substantial revenues from sales of new DVDs,
9 as well as store traffic resulting in the sales of other goods, which would have been threatened by
10 Netflix's entry into new DVD sales, and which were enhanced by Netflix's promotion of Wal-Mart
11 Stores and Walmart.com through the Market Allocation Agreement.

12 14. In a letter submitted in connection with a prior antitrust case brought against Netflix
13 by other plaintiffs for other alleged violations of law, an assistant general counsel of Wal-Mart
14 Stores, referring specifically to Wal-Mart Stores, wrote of "Wal-Mart's decision to discontinue
15 renting DVDs." Moreover, it was Wal-Mart Stores that announced in part the Market Allocation
16 Agreement, which identifies Wal-Mart Stores, in the "About" section of the press release. The
17 announcement quoted John Fleming, at the time both the Chief Marketing Officer of Wal-Mart
18 Stores and the outgoing CEO of Walmart.com still overseeing Walmart.com operations, regarding
19 the Agreement. It explained that Walmart.com's DVD sales are in fact Wal-Mart Stores' "online
20 movie sales business," and that, more generally, Wal-Mart Stores' "[o]nline merchandise sales are
21 available at www.walmart.com."

22 15. Whenever this Complaint refers to a statement or transaction of any corporation or
23 entity, the allegation means that the corporation or entity acted by or through its directors,
24 members, partners, officers, employees, affiliates, or agents, while engaged in the management,
25 direction, control, or conduct of the corporation's or entity's business and acting within its scope of
26 authority.

27
28

JURISDICTION AND VENUE

16. This Court has subject matter jurisdiction pursuant to 28 U.S.C. §§ 1331, 1332(d) & 1337 and 15 U.S.C. §§ 1-2, 15 & 26.

17. Venue is proper in this District pursuant to 28 U.S.C. §§ 15, 22 & 26 and pursuant to 28 U.S.C. § 1391(b), (c) & (d), because at all times relevant to the Complaint: (a) Defendants transacted business, were found, or acted through subsidiaries or agents present in this District; (b) a substantial part of the events at issue in Plaintiff's claims occurred in this District; and (c) a substantial portion of the affected interstate trade and commerce described below has been carried out in this District.

18. This Court has personal jurisdiction over Defendants because, *inter alia*, Netflix and Walmart.com are headquartered in this State and each of the Defendants has transacted business, maintained continuous and systemic contacts, purposefully availed itself of the benefits of doing business, and committed acts in furtherance of the alleged conspiracy in this State.

INTERSTATE TRADE AND COMMERCE

19. Defendants' conduct has taken place within the flow of, and substantially affected the interstate commerce of, the United States. By way of example, Defendants have sold and/or rented DVDs throughout the United States, involving hundreds of millions or billions of dollars in interstate commerce, and used the instrumentalities of interstate commerce, including interstate wires and the U.S. mail, to sell and/or to rent DVDs throughout the United States.

RELEVANT MARKET

20. For those claims that may require market definition, the Relevant Market for purposes of these allegations during the Class Period at least is: the rental of DVDs online by subscription for delivery by mail in the United States (the “Online DVD Rental Market”). At all relevant times, Netflix has been a competitor in the Relevant Market. Prior to entering into the Market Allocation Agreement, Defendants Wal-Mart Stores and Walmart.com competed in the Relevant Market.

21. The Market Allocation Agreement, however, is *per se* illegal and requires no allegation of market definition.

1 22. Plaintiff also alleges, in the alternative, that the Market Allocation Agreement is
2 anticompetitive and illegal under the Rule of Reason.

3 23. Among other facts alleged herein, the Defendants' conduct ended competition
4 between direct competitors in the Online DVD Rental Market, conferred market and monopoly
5 power upon Netflix in that market and has no pro-competitive benefits.

6 24. "DVD," as defined herein, refers to a Digital Video Disc or Blu-ray Disc
7 containing commercially recorded entertainment programs for personal viewing. DVDs are the
8 primary medium by which movies and other recorded entertainment are distributed in the United
9 States. Revenues on DVDs far exceed those generated from box office receipts. In addition,
10 DVDs have become a particularly lucrative means for the distribution of previously aired
11 television programs, surpassing even television syndication rights as a revenue stream in many
12 instances. As defined herein, "DVD" does not refer to blank Digital Video Discs, which are used
13 to store or record data.

14 25. At all relevant times, there have been no reasonably interchangeable substitutes for
15 the service of online DVD rentals, which is differentiated, from both the demand and the supply
16 side, from other methods of DVD distribution channels, as well as other methods of entertainment
17 content delivery.

18 26. In the Online DVD Rental Market, for a monthly subscription fee, a consumer may
19 rent DVDs from an online service provider, such as Netflix, Blockbuster Online, or (prior to its
20 exit from this market) Wal-Mart DVD Rentals. Within any given plan, the consumer pays the
21 subscription fee regardless of how many DVDs he or she rents per month. Thus, even a consumer
22 who does not rent a DVD for months still is charged the subscription fee; Netflix CEO Reed
23 Hastings has called this the "gym membership effect." To rent DVDs, consumers fill out a rental
24 "queue" in their online profile, listing in order of preference the DVDs they wish to rent. The
25 DVDs are then sent to the consumer's home via U.S. mail. To return the DVD and receive the
26 next DVD in the queue, the consumer inserts the DVD in a prepaid envelope provided with the
27 rental and mails it back; the service provider then mails the next available movie in the queue to
28 the consumer.

1 27. From the consumer's perspective, online DVD rentals are a differentiated service
 2 that is not reasonably interchangeable with in-store video rental. In video rental from stores,
 3 consumers drive to or otherwise arrive at the store, find (or do not find) what they are looking for,
 4 and, for the most part, pay on a per-DVD basis for their selection(s). After the designated rental
 5 period, usually depending upon the release date of the DVD, the consumer returns the selection or
 6 potentially incurs late fees. During the Class Period as alleged herein, these late fees have
 7 accounted for as much as 20% of the revenues in traditional video rental stores; there are no late
 8 fees or due dates in the Online DVD Rental Market.

9 28. There are numerous other practical indicia of the Online DVD Rental Market being
 10 a relevant product market, distinct from other forms of video rental, including:

11 A. **Price Competition.** No direct price competition exists between
 12 online DVD rental and other forms of video rental, whether in-store, kiosk, video-on-demand, or
 13 video downloading, which are not reasonably interchangeable with online DVD rental. For
 14 example, online DVD rentals generally are priced on a monthly subscription basis. Within any
 15 given plan, the subscription rate is independent of the number of DVDs the customer actually rents
 16 in a month. In-store DVD rentals, kiosks, and downloading generally are priced on a pay-per-view
 17 basis. Also, changes in the price of online rentals do not closely track changes in the price of in-
 18 store rentals. The pricing of online DVD rentals is generally nationwide in scope and is not
 19 affected by local in-store prices and competition. As a result, the pricing of online DVD rentals
 20 would generally be the same to a customer, regardless of whether the nearest rental store is two
 21 minutes or two hours away. Online DVD rentals generally offer additional services, such as movie
 22 reviews, customer-specific recommendations based on viewing and preference history, and other
 23 metrics of popularity. The cross-elasticity of demand between these products and services is such
 24 that a small but significant non transitory increase in price ("SSNIP") would not cause consumers
 25 to switch from online DVD rental to in-store rental or any other arguable method of DVD or video
 26 distribution, and *vice versa*.

27 B. **Functional Differences.** Online DVD rentals fundamentally differ
 28 from in-store rentals in that (1) they do not require travel to a store (including a second trip to

1 return the DVD and potentially multiple trips if the store does not have the DVD in stock at the
 2 right time), (2) are available to anyone with a postal address, regardless of proximity to a store, (3)
 3 are primarily subscription-based services, and (4) provide a much wider selection of titles than can
 4 a bricks-and-mortar store—the library of titles available from online service providers has grown
 5 over time, now ranging beyond 100,000 DVDs—often twenty to one-hundred times the selection
 6 of titles stocked (not to mention available) at any single video rental store. For these reasons,
 7 among others, online and in-store DVD rentals are not reasonably interchangeable. Likewise,
 8 other modes of video distribution, such as kiosk, video-on-demand, and downloading, among other
 9 forms, are not reasonably interchangeable with online DVD rentals for a number of reasons,
 10 including relative selection and convenience for consumers, pricing, as well as, from the supply
 11 perspective, licensing considerations and technological limitations.

12 **C. Public and Industry Perceptions.** The online rental market is recognized
 13 as a distinct market by the public and the industry, including by Defendants. For example,
 14 Defendants have confirmed and recognized the existence of a discrete online rental market. In
 15 September 2008, Netflix spokesman Steve Swasey told the Wall Street Journal that other types of
 16 rental services, such as kiosk and in-store rentals, do not present a direct competitive threat to
 17 Netflix explaining, “We see kiosks as competing with video stores. They’re very new-release
 18 centric—that’s all they offer—and that’s what the stores offer. You’re still going to a destination
 19 to pick it up, you have to return it, and you pay by the day.” Mr. Swasey acknowledged that while
 20 video downloads may be a competitive force in the future, “[m]ainstream consumers are still happy
 21 with DVDs, and probably will be for five to 10 years.”

22 29. As recently as April 24, 2009, during Netflix’s First Quarter conference call with
 23 financial analysts, Hastings said that online DVD and Blu-ray rental will “continue to grow for
 24 many years,” without regard to any advances in video downloading or other modes of content
 25 delivery. Hastings went to explain that the “key takeaway” is that “there is still a lot of growth in
 26 rental by mail. The studios clearly have a vested interest in extending the life of DVD and Blu-ray
 27 and that’s good for Netflix as well.” Indeed, Hastings observed video kiosks pose no serious
 28 competitive threat to Online DVD Rental, explaining that “Despite kiosk growth . . . we had a

1 record quarter and we expect to have a record year because our differentiators continue to be our
 2 vast selection—over 100,000 titles—the convenience of mail and streaming, that you don't have to
 3 drive anywhere to receive or return a Netflix disk, and our unlimited rentals for one flat fee.”

4 30. Online DVD rentals are also a separate market from DVD sales. The pricing of
 5 DVD sales and online DVD rentals are very different. For example, the price to buy a new DVD
 6 depends heavily on how popular it is, including whether it is a new release or how successful the
 7 title originally was at the box office or on television. By contrast, online DVD renters generally
 8 charge based on a subscription fee, regardless of whether the consumer is renting popular or
 9 obscure DVDs. The industry and the public perceive online DVD rentals as separate from DVD
 10 sales, whether in-store or online. The factors motivating a consumer to buy a DVD are different
 11 from those that lead to renting a DVD. The former generally applies to DVDs that the consumer
 12 intends to view (either personally, or their family or friends) numerous times. The latter generally
 13 applies to DVDs that the consumer intends to view once and then return. DVDs sold at retail have
 14 other distinguishing characteristics, such as packaging and special features not available with
 15 rentals, which are delivered unadorned in envelopes. In addition, the fact of whether a DVD is
 16 new or used is not an issue in rental, but is a significant factor in sales, for used DVDs are sold at a
 17 significant discount to their new counterparts. DVD sales and online rentals also are not
 18 reasonably interchangeable for consumers intending to collect physical DVDs or to give a DVD as
 19 a gift. The cross-elasticity of demand between these products and services is such that a SSNIP
 20 would not cause consumers to switch from online renting to purchasing DVDs, and *vice versa*.

21 31. The Geographic Market for the Online DVD Rental Market is the United States.
 22 The United States is the only area of effective competition where buyers can turn for alternative
 23 sources of supply of Online DVD Rental services. Among other things, shipping costs and
 24 transglobal differences in DVD data encoding make it neither practical nor feasible for entities
 25 located in other countries to rent DVDs to U.S. consumers.

MARKET AND MONOPOLY POWER

27 32. At all relevant times, Netflix dominated the Online DVD Rental Market. Netflix
 28 has had an approximate market share of 75% in the Online DVD Rental Market, and is far and

1 away the market leader in the Online DVD Rental Market. As a result of this market share, Netflix
2 has had, and continues to have, market and monopoly power in the Online DVD Rental Market; it
3 has the power to control prices or exclude competition in this Relevant Market.

4 33. Netflix also has the power to control prices or exclude competition in the Relevant
5 Market for other reasons. Specifically, Netflix (a) set subscription prices well in excess of
6 marginal costs, (b) enjoyed high profit margins thereon, (c) sold such subscriptions generally in
7 excess of the competitive price, and (d) would not, with a SSNIP for its online DVD rental
8 subscriptions (or not reducing its prices to match Blockbuster's lower prices during the Class
9 Period), lose sufficient sales to make such a price increase unprofitable.

10 34. Netflix's market and monopoly power is strengthened by the significant barriers to
11 entry in the Relevant Market. There have been no significant market entrants in the nearly six
12 years since the announcement of the Market Allocation Agreement, which increased those barriers.
13 Online DVD rental is highly capital intensive. A firm must operate on a large scale to be
14 successful. It requires the possession of a significant number of shipping facilities strategically
15 located throughout the United States to ensure timely delivery. It also requires stocking an
16 extensive inventory of DVDs to maintain the selection of titles that consumers demand. As Netflix
17 CEO Reed Hastings observed, "When you think about the barriers to entry to this business, it is
18 subtle because it appears easy. A kid can open a website. But the barriers to profitability are very
19 large." Hastings further noted that "opening a website that does rental is easy. What's hard is
20 [creating] the scale to be able to do it profitably." These barriers are far greater now than they were
21 when Netflix began. Netflix was able to enter on a much smaller scale but a new entrant today
22 would need a much larger scale of operations.

23 35. Since the implementation of the Market Allocation Agreement, the Online DVD
24 Rental Market has been overwhelmingly comprised of only two firms: Netflix and Blockbuster,
25 which possesses nearly all of the remaining 25% of the Online DVD Rental Market that Netflix
26 does not control. Blockbuster's presence does not preclude Netflix's monopoly and market power.
27 Reed Hastings has stated that Blockbuster actually "works very well for us" because it creates "a
28 lot of press" but, from a competitive perspective, it has a "relatively not strong balance sheet and

[is] in the business in a small way.” A few minor firms have shares of less than 1-2% of the market. During fiscal years 2005-2008 combined, Netflix earned more than \$5 Billion in revenues and nearly \$2 Billion in gross profit from renting DVDs to consumers—a margin of nearly 40%. As a result of Netflix’s market and monopoly power alleged herein, its subscription fees have been higher than they otherwise would have been.

36. Further evidence of Netflix's market and monopoly power is reflected in the
anticompetitive effects alleged herein.

THE ILLEGAL AGREEMENT

9 37. **Pre-Agreement Competition in the Online DVD Rental Market.** In early 2005,
10 Netflix was coming off a year in which competition was growing and its stock price had dropped
11 precipitously. It faced increasing competition from Wal-Mart DVD Rentals and from Blockbuster
12 Online, the latter of which had just entered the Online DVD Rental Market.

13 38. By mid-2004, Netflix was charging \$21.99 for its most popular subscription rental
14 plan. Blockbuster entered the online market in earnest in August, at first charging \$19.99 but then
15 reducing its price in November to \$17.49 for its similar plan. After that, the Wal-Mart DVD
16 Rentals rate was reduced from \$18.86 to \$17.36. In the wake of these price cuts, Netflix reduced
17 its prices by nearly 20% to \$17.99 per month. After that, Blockbuster further decreased its price to
18 \$14.99—20% below Netflix’s already reduced price and more than 40% below the price Netflix
19 was charging just months earlier.

20 39. Meanwhile, Wal-Mart Stores and its wholly-owned subsidiary Walmart.com, which
21 had established themselves as the leader in new DVD sales, were facing increasing competition
22 from in-store and online channels of distribution in new DVD sales, including competition from
23 Amazon.com. At the time, Netflix was a significant potential additional competitor, since it had a
24 subscriber base of millions of customers who were also known to be prolific DVD buyers, and the
25 sales and profits of Wal-Mart Stores and Walmart.com stood to suffer if Netflix began selling new
26 DVDs to these customers. Conversely, Wal-Mart Stores and Walmart.com stood to gain
27 significant additional sales and profits and to gain further market share in the sale of new DVDs if
28 these customers were to make their purchases of new DVDs from them instead.

1 **40. Walmart.com's success and plans for the online DVD rental business prior to**
2 **the Agreement.** From its beginnings in 2003 through the January 2005 dinner, Walmart.com
3 trumpeted the success of its online DVD rental service. As early as November 2003, Cynthia Lin,
4 a spokeswoman for Walmart.com, observed that "Customers have really been responsive to the
5 convenience of ordering online. . . . There's definitely a large appetite for this." And, in February
6 2004, Walmart.com said it was "seeing superb growth" in Wal-Mart DVD Rentals. By April 2004,
7 Walmart.com said its gains in monthly subscribers were "exceeding expectations." On October
8 24, 2004, only a few months prior to the January dinner, Kevin Swint, Walmart.com's director of
9 entertainment and photo said that Wal-Mart DVD Rentals had "grown beyond our expectations"
10 and that "We're really bullish about this service . . . and our customers are enthusiastic."

11 **41.** The recognition of the potential of its DVD rental business also was reflected in the
12 dramatic expansion of Wal-Mart DVD Rentals during 2004 by the doubling of its capacity and
13 expressions of plans to continue that expansion in 2005. During 2004, for instance, Wal-Mart
14 DVD Rentals expanded its DVD selection from 13,000 titles to 20,000 and doubled the number of
15 distribution centers from 7 to 14. In December 2004, Amy Colella, a spokeswoman for
16 Walmart.com, said that the business was going to add even more distribution centers the following
17 year. As Colella explained on December 29, 2004: "It's a viable business for us, with growth
18 potential." During a January 7, 2005 interview, within days of the January dinner of CEOs
19 Hastings and Fleming, Walmart.com CEO John Fleming told CNBC that Wal-Mart DVD Rentals
20 was among its "very good businesses that we're focused on developing over the next year or two."

21 **42. The Wal-Mart DVD Rentals Price Cut.** On that same day, January 7, 2005, Wal-
22 Mart DVD Rentals dropped the price on its most popular DVD rental plan significantly—to \$12.97
23 per month—creating further price pressure on Netflix to reduce its DVD rental prices. In order to
24 respond to the increased competition, Netflix would have been forced to lower its prices and
25 thereby reduce its profits. This increased competition was not good news for Netflix. "Since its
26 core business is online DVD rentals, Netflix might have been the company most threatened by
27 Wal-Mart's push into the sector," as one industry publication then noted. That publication further
28 explained, "Because of its size, buying power and agreements with movie distributors, Wal-Mart

1 could have put significant pricing pressure on Netflix over time, analysts said.” This growing price
 2 disparity plainly was not good news for Netflix, even though it was for consumers.

3 **43. The January Dinner Meeting.** Faced with this increasing competition, Reed
 4 Hastings, the Chairman and CEO of Netflix, called John Fleming, then the CEO of Walmart.com,
 5 and invited him to dinner to discuss their companies’ (then) competing businesses. Fleming
 6 accepted the invitation; they met in January 2005, “started talking about how we could work
 7 together” (according to Hastings), and embarked upon a scheme that would result in the Market
 8 Allocation Agreement.

9 **44. Hastings’ Subsequent “Prediction.”** On April 21, 2005, in Netflix’s First Quarter
 10 earnings call with financial analysts, held after the January dinner, but less than one month prior to
 11 the public announcement of the Market Allocation Agreement, Hastings made plain the motive for
 12 Netflix to conspire with Wal-Mart Stores and Walmart.com:

13 In terms of profitability over the coming years, the key issue is the number of major
 14 competitors. If there are only two major players, Blockbuster and Netflix, the
 15 profitability may be substantial like other two-firm entertainment markets. If, on
 16 the other hand, Amazon, Wal-Mart, Blockbuster and Netflix are all major
 17 competitors in online rental, then the profits would likely be small.

18 Hastings went on to “predict” on that conference call:

19 [T]he likely case is [that] online rental becomes a two-firm market over the coming
 20 years.

21 **45. The Public Announcement.** On May 19, 2005, shortly after Fleming had been
 22 promoted by Wal-Mart Stores from his position at Walmart.com in Brisbane to be the Chief
 23 Marketing Officer of Wal-Mart Stores in Bentonville, Defendants issued a joint press release that
 24 revealed the existence of the Market Allocation Agreement. By entering into the Market
 25 Allocation Agreement, Defendants unlawfully divided and allocated the markets for DVD sales
 26 and rentals, and did, in fact, create the two-firm market that Hastings sought. Recognizing the
 27 tremendous benefits that this improper agreement would bring to them, Hastings admitted that
 28 “This agreement bolsters both Netflix’s leadership in DVD movie rentals and Wal-Mart’s strong
 movie sales business.”

29 **46. The Media’s Reaction.** The news of the agreement was featured in a number of
 30 newspapers and other publications, in articles with aptly colorful titles, such as:

- 1 • “Wal-Mart and Netflix Scratch Each Other’s Backs,”
- 2 • “Truce in DVD-Rental Wars,”
- 3 • “Wal-Mart and Netflix: An Alliance,” and
- 4 • “Wal-Mart Loves Netflix: And Vice-Versa.”

5 **47. The Execution.** Beginning on May 19, 2005, Walmart.com, as agreed, did in fact
 6 exit the Online DVD Rental Market. Walmart.com announced to all of the subscribers to Wal-
 7 Mart DVD Rentals that it was exiting the Relevant Market and that those subscribers could be
 8 transferred to Netflix. Walmart.com took additional steps to affirmatively implement the Market
 9 Allocation Agreement by adding a prominently placed link to the Netflix website to encourage
 10 customers to transfer their subscriptions to and otherwise rent from Netflix. Since the date of their
 11 joint announcement on May 19, 2005 (apart from the 30 days that Walmart.com used to wind
 12 down its existing online rental business), neither Walmart.com nor Wal-Mart Stores has
 13 participated in the Online DVD Rental Market, and Netflix has not sold new DVDs.

14 **48.** As a result of the Market Allocation Agreement, downward pricing pressure from
 15 Walmart.com was eliminated and the Online DVD Rental Market was reduced to two competitors.
 16 Absent the Market Allocation Agreement, Netflix would have lowered its prices no later than May
 17 19, 2005. As a result of the elimination of a competitor in this Relevant Market, Netflix was able
 18 to hold its subscription rate steady at \$17.99 per month and its only competitor left, Blockbuster,
 19 was able to raise its subscription price in July to match that of Netflix, from \$14.99 per month to
 20 \$17.99 per month. This was in accord with Hastings’ expectation that “[i]f there are only two
 21 major players, Blockbuster and Netflix, the profitability may be substantial like other two-firm
 22 entertainment markets.” As one business publication proclaimed: “That’s one less competitor for
 23 the DVD rental pioneer . . . Now it looks like the competitive storm is dying down.” In Netflix’s
 24 next earnings call, on July 25, 2005, Hastings boasted:

25 Last quarter we said online rental was shaping up to be a two-player market, and
 26 that is indeed what is happening.

27 **49.** The Market Allocation Agreement was not in the independent self-interest of Wal-
 28 Mart Stores, Walmart.com, or Netflix. Neither Wal-Mart Stores nor Walmart.com would have

1 wanted Walmart.com to withdraw from the online rental market, encourage its subscribers to be
2 transferred to Netflix, and promote Netflix's rental business absent substantial consideration from
3 Netflix, such as an agreement not to compete for new DVD retail sales. But for the Market
4 Allocation Agreement, Walmart.com would not have exited the Online DVD Rental Market when
5 it did. Likewise, Netflix would not have foreclosed its opportunity to sell DVDs to its millions of
6 subscribers—a base of customers who purchase on average 25 DVDs per year each—and would
7 not have promoted new DVD sales by Wal-Mart Stores and Walmart.com, rather than its own
8 sales, absent an agreement from them not to compete against Netflix's online rental business.

9 50. Walmart.com's exit from the Online DVD Rental Market was not a unilateral
10 decision. It was a key element of the Market Allocation Agreement as set forth herein. First,
11 Walmart.com's exit was expressly part of the Market Allocation Agreement with Netflix that
12 directly stemmed from the meeting between the two companies' CEOs. Prior to that Agreement,
13 Walmart.com had not announced anything about exiting this market. Second, as detailed above,
14 shortly prior to the January dinner Walmart.com repeatedly described its success in the online
15 DVD rental business and expressed its intention to continue and expand in that business. Its
16 conduct after the January meeting thus represents a sudden and sharp reversal in its plans. Third,
17 Walmart.com cut its price shortly before the January dinner. It would not have done so had it
18 planned to exit the Online DVD Rental Market. Such a price cut only makes sense if
19 Walmart.com planned to remain a long-term competitor in that market. Fourth, the fact that the
20 dinner was initiated by Reed Hastings right around the time of Walmart.com's price cut and
21 numerous announcements of its intention to continue and expand its online DVD rental business,
22 contradicts any assertion that the dinner stemmed from a unilateral decision by Walmart.com to
23 exit the market.

24 51. **Single agreement.** The conduct alleged herein constitutes a single overarching
25 conspiracy consisting of both the terms that were publicly announced as well as the other aspects
26 of the Market Allocation Agreement.

ANTICOMPETITIVE EFFECTS

28 ||| 52. Defendants' illegal acts and practices have caused anticompetitive effects in the

1 Online DVD Rental Market. The subscription fees charged by Netflix to Plaintiff, as well as the
2 other members of the Class, were maintained at artificially high and supracompetitive levels.
3 Plaintiff and the other members of the Class paid higher subscription prices to Netflix than they
4 otherwise would have paid. As one industry publication reported at the time of the Agreement,
5 “[b]ecause of its size, buying power and agreements with movie distributors, Wal-Mart could have
6 put significant pricing pressure on Netflix over time, analysts said.”

7 53. The Market Allocation Agreement (i) eliminated one of only three significant
8 competitors in the Relevant Market, (ii) eliminated competition between Defendants, and (iii)
9 enabled Netflix to acquire market power and also acquire and maintain monopoly power in the
10 Relevant Market. The Market Allocation Agreement has enabled Netflix to implement
11 monopolistic and supracompetitive pricing in the Relevant Market.

12 54. The Market Allocation Agreement and Defendants' acts and practices in
13 furtherance thereof have no procompetitive benefits. The co-promotion aspects of the
14 Agreement do not create information that consumers need, nor do they create new or better
15 products or services. Rather, they have served to reinforce the true anticompetitive nature of the
16 Market Allocation Agreement by assuring, for example, that Walmart.com not only withdrew from
17 the Online DVD Rental Market, but further enhanced Netflix's position in that market. Even if
18 there were any such benefits, they would not outweigh any of the anticompetitive effects described
19 herein, and, in any event, could be achieved by less restrictive means.

20 55. Defendants' market allocation scheme is a naked restraint of trade; it was not and is
21 not ancillary to any legitimate business collaboration. Rather, the market allocation scheme was a
22 core activity of the Market Allocation Agreement itself. The co-promotion aspects of the
23 Agreement were a means to reinforce the market allocation. To the extent that those aspects were
24 portrayed as the sole reason for the Market Allocation Agreement, that portrayal was misleading
25 and pretextual, allowing Defendants' market allocation conspiracy to escape scrutiny and "hide in
26 plain sight."

CLASS ACTION ALLEGATIONS

28 | 56. Plaintiff brings this action on his own behalf and as a class action under Rules

1 23(a), 23(b)(2), and 23(b)(3) of the Federal Rules of Civil Procedure on behalf of all members of
2 the following Class:

3 Any person or entity in the United States that paid a subscription fee to Netflix on
4 or after May 19, 2005 up to and including the date of class certification.

5 Excluded from the Class are government entities, Defendants, their co-
6 conspirators, Reed Hastings, John Fleming, Defendants' subsidiaries, corporate
7 affiliates, and counsel in this action. Also excluded are persons who subscribed to
8 Wal-Mart DVD Rentals as of May 19, 2005. Also excluded are the Judge presiding
over this action, her law clerks, her spouse, or any person within the third degree of
relationship to either of them, or the spouse of such a person, within the meaning of
28 U.S.C. § 455.

9
10 57. The Class numbers in the millions, the exact number and identities of the
11 members being known by Defendants.

12 58. The Class is so numerous and geographically dispersed that joinder of all members
13 is impracticable.

14 59. There are questions of law and fact common to the Class and the members
15 thereof. These common questions relate to the existence of the conspiracy alleged, and to the
16 type and common pattern of injuries sustained as a result thereof. The questions include, but are
17 not limited to:

- 18 a. Whether Defendants engaged in a contract, combination, or conspiracy to
allocate markets;
- 19 b. Whether Defendants unreasonably restrained trade in the Online DVD
Rental Market;
- 20 c. Whether Defendants had the specific intent for Netflix to monopolize the
Online DVD Rental Market;
- 21 d. The nature and character of the acts performed by Defendants in the
furtherance of the alleged contract, combination, and conspiracy;
- 22 e. Whether the alleged contract, combination, and conspiracy violated
Section 1 of the Sherman Act;
- 23 f. Whether the alleged contract, combination, and conspiracy and other
conduct violated Section 2 of the Sherman Act;
- 24 g. The anticompetitive effects of Defendants' violations of law;
- 25 h. Whether Defendants have acted or refused to act on grounds generally
applicable to the Class, thereby making appropriate final injunctive relief or

1 corresponding declaratory relief with respect to the Class as a whole; and

- 2 i. Whether the conduct of Defendants, as alleged in this Complaint,
3 caused Netflix subscription fees to be higher than they otherwise would
4 have been and thereby caused injury to the business and property of
Plaintiff and other members of the Class.

5 60. The questions of law and fact common to the members of the Class predominate
6 over any questions affecting only individual members, including the legal and factual issues
7 relating to liability and damages.

8 61. Plaintiff is a member of the Class. Plaintiff's claims are typical of the claims of
9 other members of the Class, and they will fairly and adequately protect the interests of the
10 members of the Class. Their interests are aligned with, and not antagonistic to, those of the
11 other members of the Class.

12 62. Plaintiff is represented by counsel who are competent and experienced in class
13 action antitrust litigation.

14 63. A class action is superior to other available methods for the fair and efficient
15 adjudication of this controversy. Class treatment will permit the adjudication of relatively small
16 claims by members of the Class who otherwise could not afford to litigate antitrust claims such as
17 are asserted in this Complaint. This class action presents no difficulties of management that would
18 preclude its maintenance as a class action.

19 **ANTITRUST INJURY AND STANDING**

20 64. During the Class Period, Plaintiff and the members of the Class have directly paid
21 monthly DVD subscription fees to Netflix in the United States, and many continue to do so.

22 65. Plaintiff and the members of the Class have suffered, and many continue to suffer,
23 injury of the type that the antitrust laws are designed to punish and prevent. Plaintiff and the
24 members of the Class have paid, and many continue to pay, more to subscribe to Netflix than they
25 would have, absent the Market Allocation Agreement. As a direct and proximate result of the
26 unreasonable restraint of trade and market and monopoly power created by the Market Allocation
27 Agreement, which is continuing to this day, Plaintiff and the members of the Class were, and many
28 continue to be, injured and financially damaged in their businesses and property, in amounts that

1 are not presently determined. As the direct victims of Defendants' antitrust violations, Plaintiff is
 2 an efficient enforcer of the antitrust claims made herein.

3 **COUNT ONE**

4 **SHERMAN ACT SECTION ONE (15 U.S.C. § 1)**
 5 **Market Allocation of Online DVD Rental Market**
 (Against All Defendants)

6 66. Plaintiff realleges each allegation set forth above, as if fully set forth herein.

7 67. Defendants have entered into a per se illegal market division agreement, in violation
 8 of Section 1 of the Sherman Antitrust Act, 15 U.S.C. § 1.

9 68. In the alternative, if evaluated under the Rule of Reason, the Market Allocation
 10 Agreement is an unreasonable restraint of trade in violation of Section 1 of the Sherman Antitrust
 11 Act, 15 U.S.C. § 1.

12 69. Prior to and at the time of the agreement, Netflix and Walmart.com were actual
 13 competitors in the Online DVD Rental Market. In addition, Netflix was a potential competitor of
 14 Wal-Mart Stores and Walmart.com in new DVD sales. Wal-Mart Stores and Walmart.com were
 15 actual participants and Netflix was a potential participant, with the means and economic incentive
 16 to sell new DVDs—in the absence of the Market Allocation Agreement.

17 70. Defendants shared a conscious commitment to a common scheme designed to
 18 achieve the unlawful objective of allocating the markets for online DVD rentals and new DVD
 19 sales. The Market Allocation Agreement allocated the Online DVD Rental Market to Netflix, with
 20 Wal-Mart Stores and Walmart.com agreeing not to compete in that market. The agreement also
 21 allocated new DVD sales to Wal-Mart Stores and Walmart.com, with Netflix agreeing to refrain
 22 from selling new DVDs in competition with them.

23 71. In addition to explicitly or *de facto* agreeing not to sell new DVDs, Netflix also
 24 obtained the Market Allocation Agreement by providing potentially valuable promotion to Wal-
 25 Mart Stores and Walmart.com. In so doing, Netflix provided significant consideration to Wal-
 26 Mart Stores and Walmart.com for their agreement that Walmart.com would withdraw from, and
 27 both Walmart.com and Wal-Mart Stores would not compete in, the Online DVD Rental Market.

28 72. The Market Allocation Agreement has created significant anticompetitive effects

1 and no pro-competitive benefits. It eliminated competition in the Relevant Market, raising prices
2 paid by consumers. To the extent that there were any procompetitive benefits resulting from the
3 agreement, they would not outweigh the agreement's anticompetitive effects and could have been
4 achieved by less restrictive means.

5 73. As a result of this violation of law, Netflix's subscription prices charged to, and
6 paid by, Plaintiff and the Class are, and have been, higher than they otherwise would have been.

COUNT TWO

SHERMAN ACT SECTION TWO (15 U.S.C. § 2)
Monopolization of Online DVD Rental Market
(Against Netflix)

74. Plaintiff realleges each allegation set forth above, as if fully set forth herein.

11 75. Netflix has monopoly power in the Online DVD Rental Market.

12 76. Netflix willfully acquired and maintained its monopoly in the Online DVD Rental
13 Market by its acts and practices described herein, including by executing, implementing, and
14 otherwise complying with the Market Allocation Agreement, in violation of Section 2 of the
15 Sherman Antitrust Act, 15 U.S.C. § 2. That monopolization was achieved or strengthened through
16 restrictive or exclusionary conduct, rather than by means of superior business acumen. It was
17 Netflix's conscious object to further its dominance in the relevant market by and through the
18 Market Allocation Agreement.

19 77. As a result of this violation of law, Netflix's subscription prices charged to, and
20 paid by, Plaintiff and the Class are, and have been, higher than they otherwise would have been.

COUNT THREE

**SHERMAN ACT SECTION TWO (15 U.S.C. § 2)
Attempt to Monopolize Online DVD Rental Market
(Against Netflix)**

24 78. Plaintiff realleges each allegation set forth above, as if fully set forth herein.

25 79. If Netflix does not already have monopoly power, then Netflix has a dangerous
26 probability of success in achieving monopoly power in the Online DVD Rental Market.

27 80. With the specific intent to achieve a monopoly, Netflix, by its acts and practices
28 described herein, including by executing, implementing, and otherwise complying with the Market

1 Allocation Agreement, has attempted to monopolize the Online DVD Rental Market, in violation
2 of Section 2 of the Sherman Antitrust Act, 15 U.S.C. § 2. It was Netflix's conscious object to
3 control prices and/or exclude competition in the relevant market.

4 81. As a result of this violation of law, Netflix's subscription prices charged to, and
5 paid by, Plaintiff and the Class are, and have been, higher than they otherwise would have been.

COUNT FOUR

**SHERMAN ACT SECTION TWO (15 U.S.C. § 2)
Conspiracy to Monopolize Online DVD Rental Market
(Against All Defendants)**

82. Plaintiff realleges each allegation set forth above, as if fully set forth herein.

10 83. Defendants shared a conscious commitment to a common scheme designed to
11 achieve the unlawful objective of the monopolization of the Online DVD Rental Market. Prior to
12 and at the time of the Agreement, Netflix and Walmart.com were actual competitors in that market.
13 Defendants conspired with the specific intent, knowledge and purpose that their anticompetitive
14 agreement would result in Netflix willfully acquiring and maintaining a monopoly in the Relevant
15 Market. Wal-Mart Stores and Walmart.com knew that the natural and probable consequence of the
16 Market Allocation Agreement would be the monopolization of the Relevant Market by Netflix.
17 Defendants have committed overt acts in furtherance of their conspiracy, including entering into,
18 complying with, and implementing the Market Allocation Agreement, in violation of Section 2 of
19 the Sherman Antitrust Act, 15 U.S.C. § 2.

84. As a result of this violation of law, Netflix's subscription prices charged to, and
paid by, Plaintiff and the Class are, and have been, higher than they otherwise would have been.

PRAAYER FOR RELIEF

WHEREFORE, Plaintiff respectfully requests that:

- A. The Court determine that this action may be maintained as a class action under Rule 23 of the Federal Rules of Civil Procedure and that Plaintiff be appointed a class representative.
 - B. Defendants be adjudged to violate Sections 1 and 2 of the Sherman Antitrust Act, 15 U.S.C. §§ 1-2.
 - C. The Court declare the Market Allocation Agreement between Defendants announced May 19, 2005, to be unlawful and null and void.

- 1 D. Judgment be entered for Plaintiff and the members of the Class against
2 Defendants, jointly and severally, for three times the amount of damages
3 sustained by Plaintiff and the Class, under Section 4 of the Clayton Antitrust
4 Act, 15 U.S.C. § 15, together with the costs of the action, including
5 reasonable attorneys' fees, and such other relief as is appropriate.
- 6 E. Defendants, their affiliates, successors, transferees, assignees, and the
7 officers, directors, partners, agents and employees thereof, and all other
8 persons acting or claiming to act on their behalf, be permanently enjoined
9 and restrained from, in any manner, continuing, maintaining or renewing the
10 contract, combination or conspiracy alleged herein, or from engaging in any
11 other contract, combination or conspiracy having similar purpose or effect,
12 and from adopting or following any practice, plan, program or device having
13 a similar purpose or effect, pursuant to Section 16 of the Clayton Antitrust
14 Act, 15 U.S.C. § 26.
- 15 F. Plaintiff and the members of the Class have such other, further, and different
16 relief as the case may require and the Court may deem just and proper under
17 the circumstances.
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JURY DEMAND

Pursuant to Rule 38(a) of the Federal Rules of Civil Procedure, Plaintiff demands a jury trial of all issues triable by jury.

Dated: April 19, 2011

Craig C. Corbitt (83251)
Michael S. Christian (212716)
ZELLE HOFMANN VOELBEL &
MASON LLP
44 Montgomery Street, Suite 3400
San Francisco, CA 94104
Telephone: (415) 693-0700
Facsimile: (415) 693-0770
ccorbitt@zelle.com
mchristian@zelle.com

Counsel for Plaintiff

3224279v1